IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 251

ATLANTIC CITY ELECTRIC COMPANY, *Petitioner*

v.

THE UNITED STATES, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The petitioner, Atlantic City Electric Company, prays that a writ of certiorari issue to review the judgment of the Court of Claims in the above-entitled case.

OPINION BELOW

The opinion of the Court of Claims, (Appendix, *infra*, pp. 1a-16a) is officially reported at 161 F. Supp. 811.

JURISDICTION

The judgment of the Court of Claims was entered on May 7, 1958. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Did the Court of Claims err in holding that a distribution to petitioner's stockholders paid out of its accumulated earnings and profits as a premium upon the redemption of its preferred stock was not a dividend as defined in Section 115(a) of the Internal Revenue Code of 1939 and, therefore, was not a dividend within the meaning of Section 26(h) of that Code?

STATUTES INVOLVED

Internal Revenue Code of 1939:

"Sec. 26. CREDITS OF CORPORATIONS.

"In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * * *

"(h) Credit for Dividends Paid on Certain Preferred Stock.—

"(1) Amount of Credit.—In the case of a public utility, the amount of dividends paid during the taxable year on its preferred stock. . . ."

"Sec. 115. DISTRIBUTION BY CORPORATIONS.

"(a) Definition of Dividend.—The term 'dividend' when used in this chapter . . . , section 204(c)(11) and section 207(a)(2) and (b)(3) . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits

accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made . . ."

STATEMENT

On May 15, 1944, the petitioner redeemed its 6 percent preferred stock for $120 per share. Of such redemption payment $100 representing the par value of the stock was paid from petitioner's capital account and $20 representing the redemption premium was paid from its accumulated earnings and profits (R. p. 23, ¶ 4). Such payment from earnings or profits constituted a dividend within the meaning of Section 115(a) of the Internal Revenue Code of 1939.

In enacting the Revenue Act of 1942, Congress added subsection (h) to Section 26 of the Internal Revenue Code of 1939. That subsection granted to public utilities a credit for dividends paid on preferred stock in the computation of surtax net income. In providing this credit Congress intended to effect a parity between nonutility corporations whose financial structure had been obtained from the issuance of bonds, the interest on which, including redemption premiums, was deductible, and public utilities which were prohibited from issuing bonds for financing purposes to the same extent as other corporations. Without such credit the additional tax burden imposed by the high surtax rates prescribed by the 1942 Act would have reduced the return of utilities severely below that contemplated by the rate-making authorities and therefore would have necessitated an increase in the existing rates.

The Commissioner of Internal Revenue refused to allow this petitioner the credit provided by Congress, and the court below, in sustaining the Commissioner's determination, has prejudiced not only the petitioner but all other utility companies similarly situated.

The petitioner is, and during the year 1944 here involved was, a public utility engaged in the sale of electric energy, the rates for which were duly established and approved by the Board of Public Utility Commissioners of the State of New Jersey (R. p. 22, ¶-1).

It has not been challenged by the respondent, and the court below has found (R. p. 13), that the preferred stock here involved qualifies in all respects for the benefits prescribed by Code Section 26(h).

REASONS FOR GRANTING THE WRIT

Certiorari is requested on the following grounds:

The decision below is in direct conflict with this Court's prior holding that the definition of the term "dividend" in Code Section 115(a) is applicable "for the purpose of the whole title," and accordingly "is infused into" the other sections of the income tax law. *Commissioner* v. *Bedford,* 325 U.S. 283, 292 (1945).

The lower court erroneously failed or refused to apply to petitioner's distribution the specific statutory definition of the term "dividend." Such failure or refusal deprived petitioner of a credit against surtax net income which Congress granted to public utilities in enacting Code Section 26(h) for the purpose of effecting a parity of tax treatment between non-utility corporations who were permitted to utilize bonds to obtain their financial structures and utility

corporations who were restricted in the use of bonds for such purposes.

The decision of the court below is an unprecedented departure from established law. It holds for the first time, so far as petitioner has been able to ascertain, that the term "dividend" as defined in Code Section 115(a) does not embrace all distributions to stockholders out of corporate earnings or profits accumulated after February 28, 1913, but only certain distributions as yet undefined. In effect, the lower court holds that where the distribution is not taxable as ordinary income to the recipient stockholder, it is not a dividend so far as the distributing corporation is concerned, in complete disregard of the fact that the tax treatment to the stockholder is due to a specific provision of law. Thus, the court's decision creates a fiction which results in a reduction of accumulated earnings and profits by a distribution to stockholders which is not a "dividend" even though it conforms to the specific definition of that term in Code Section 115(a).

The foregoing anomaly results because the lower court has erroneously applied to the petitioner's distribution certain statutory provisions and judicial decisions prescribing the tax treatment to be accorded liquidating dividends in the hands of shareholders, in complete disregard of the fact that, except for those specific provisions, the amount of petitioner's redemption premium would have been taxable to the recipient shareholders as ordinary dividend income.

The question here presented involves the fundamental tax treatment to be accorded corporate distributions from the standpoint of distributing

corporations. The question is of immediate paramount importance to the vast utility industry because, as is obvious, the denial of the credit reducing surtax net income by the amount of preferred stock redemption premiums results in higher income taxes and decreases net earnings to utilities. Such decrease in net earnings reduces the rate of return of public utilities on their capital investments and, therefore, will require rate increases to restore such return to that contemplated by the rate-making authorities.[1]

ARGUMENT

In enacting the Revenue Act of 1942 Congress, in Section 133 thereof, amended Section 26 of the Internal Revenue Code of 1939 by adding thereto subsection (h) which granted to public utilities a credit for dividends paid on preferred stock in the computation of surtax net income. The said subsection defines the terms "public utility" and "preferred stock" and the court below has found that the petitioner and the stock here involved fully conform to the statutory definitions. This leaves for resolution only the question of whether the premium paid by the petitioner upon the redemption of its preferred stock constitutes a dividend.

The term "dividend" is defined in Code Section 115(a) and that definition applies to all sections of the Code where the term is used. *Commissioner* v. *Bedford, supra.* Therefore, that definition must control in applying the provisions of Section 26(h).

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[1] Petitioner has been advised that two other petitions for certiorari have recently been filed in this Court, both involving the issue here presented, i.e. *General Public Utilities Corporation* v. *The United States* (No. 226) and *Idaho Power Company* v. *The United States* (No. 236), both decided by the Court of Claims on July 16, 1958.

Code Section 115(a) defines the term "dividend" as follows:

> "The term 'dividend' when used in this chapter . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, . . ."

It will be noted that insofar as is here relevant, Section 115(a) imposes only two requirements; i.e., (1) the distribution must be made to shareholders and (2) the distribution must be made out of earnings or profits accumulated after February 28, 1913. If these two conditions are satisfied, the distribution qualifies as a dividend.

The court below has found (R. p. 23, Fdg. 4) that petitioner's distribution was made to its "general public stockholders" and that (*idem*) the redemption premium was paid out of accumulated "earnings or profits." Therefore, under the clear and unequivocal provisions of Code Section 115(a) as construed in the *Bedford* case, *supra*, the petitioner is entitled to the credit here claimed.

In denying the relief claimed by the petitioner the court below diverted its attention from the provisions of the statute directly applicable to the distributing corporation and focused its attention upon Code provisions specifically enacted to control the tax treatment of liquidating distributions in the hands of recipient stockholders. Such treatment is prescribed by Section 115(c) of the 1939 Code which provides in material part as follows:

> "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment

in exchange for the stock, and amounts distributed in partial liquidation . . . as in part or full payment in exchange for the stock. . . ."

The foregoing provision has the effect of taxing to the stockholder as capital gain that portion of a liquidating distribution which exceeds his cost or other basis whereas, absent such provision, the excess would be taxable as ordinary income. But that provision does not alter the fact that the distribution is a dividend from the corporate standpoint to the extent that there are earnings or profits available as there were in the instant case.

It must be borne in mind that Code Section 26(h) and Code Section 115(c) were enacted for entirely different purposes. The former was adopted for the specific purpose of granting relief to public utilities who were compelled to finance their operations by the issuance of preferred stock rather than through bond issues, which latter method was available to other corporations.[2] The latter section was enacted solely for the relief of individual stockholders who, absent such provision, had been taxed at ordinary income rates on any portion of corporate distributions paid out of earnings or profits. (See Senate Finance Committee Report No. 398, pp. 11-12, 1924 Revenue Act.) The two sections above referred to are wholly unrelated, but the lower court in denying petitioner's claim concluded, in effect, that symmetry must exist

[2] The discount on a bond, which is similar to the redemption premium on the preferred stock here involved, is deductible by a nonutility corporation as interest. *Helvering* v. *Union Pac. R. Co.*, 293 U.S. 282 (1934). Such discount, however, is a capital gain when received by the bondholder. *Commissioner* v. *Caulkins*, 144 F. 2d 482 (C.A. 6, 1944).

in the tax treatment between the distributing corporation and the recipient stockholder. This conclusion was adopted nothwithstanding the specific rejection by the court of the Government's insistence that such symmetry was required. The court said (R. p. 16):

> "We are not persuaded, then, by the Government's argument for symmetry in the interpretation of section 115(c). We think it is fair for the plaintiff to urge that the definition in section 115(a) covers its case, and is not negatived by section 115(c)."

The court then discusses other decisions which relate either to distributions in the hands of stockholders or to the application of Section 27(g) to corporate distributions in liquidation but obviously such cases are wholly inapplicable. In its discussion the court cites and quotes from *Hellmich* v. *Hellman*, 276 U.S. 233, and appears to be considerably impressed with this Court's holding that the definition of the term "dividend" in Section 201(a) of the Revenue Act of 1918, 40 Stat. 1057, 1069, (115(a) of the 1939 Code) did not apply to a distribution in liquidation because that section must be read with Section 201(c) (here 115(c)) which latter section required that payments received in liquidation be treated as the purchase price of the liquidated stock. But, here again, the case involved simply the tax treatment to be accorded the payments in hands of the shareholders and such treatment was specifically prescribed by the statute. This fact appears to have been recognized by the court below in stating (R. p. 18):

> "The *Hellmich* case was, of course, concerned with the status of the distributed money in the

> hands of the distributee, as a dividend *vel non*. The Court's language, like the language of the statute, does not tell us whether the payment would have the nondividend status as regards the distributor-corporation, which is our problem in the instant case. . . ."

But, that distinction was not given effect in the court's conclusion. The court ignores the fact that the capital gain treatment accorded a liquidating dividend in the hands of a stockholder is due to the specific provisions of Code Section 115(c) authorizing such treatment, and that that section has no application to the tax treatment of the distribution from the standpoint of the distributing corporation. Indeed, during the periods when the provisions of Code Section 115(c) and its antecedent provisions were not in effect stockholders were taxed at ordinary income tax rates upon any portion of a corporate distribution paid out of earnings or profits. (See *United States* v. *Phellis*, 257 U.S. 156, 171-172.)

As an inescapable corollary to the foregoing, if the credit granted public utilities by Section 26(h) must depend upon the taxable status of the distribution in the hands of the stockholders, the credit would be allowable only during the years Code Section 115(c), or its antecedents, was in effect and not allowable during those years when capital gain treatment was not granted to the stockholders. Certainly, there is no indication in the language of Code Section 26(h) of any intention by Congress to enact such a flexible provision, and it is reasonable to assume that any intention to make the operation of that section dependent upon, or correlative to, Code Section 115(c) would have been expressed in clear and unambiguous

terms. Furthermore, the petitioner has been unable to find any other case holding that a distribution by a corporation to its shareholders out of accumulated earnings or profits did not constitute a dividend paid as far as the corporation was concerned.[3]

The Court of Claims states (R. p. 21), "Our instant problem has not been decided by any court" and, with frankness and candor, appears to express considerable doubt as to the correctness of its conclusion. Thus, because of the importance of the question in its effect upon all public utilities the decision of the court below should be reviewed and the issue resolved by this Court.

CONCLUSION

The Court of Claims has erroneously construed Code Section 115(a) of the Internal Revenue Code of 1939 and thus denied to this petitioner a tax credit which Congress by Code Section 26(h) granted in the computation of surtax net income, and the basic reasoning of the court below in arriving at its conclusion is in conflict with the decision of this Court in *Commissioner* v. *Bedford*, *supra*. The problem is most important as it affects all public utilities in the country whose financial structures were obtained through the issuance of preferred stock.

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[3] The cases of *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177 (C.A. 7) and *St. Louis Co.* v. *United States*, 237 F. 2d 151 (C.A. 3) *cert.* den. 352 U.S. 1001, cited by the court below, afford no support for its conclusion because those cases involved the application of Code Section 27(g) to deficit corporations in liquidation and not the application of Section 26(h) to distributions of accumulated earnings and profits which is the question here involved.

Therefore, the within petition should be granted and a writ of certiorari issued to the Court of Claims to review its decision herein.

Respectfully submitted,

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APPENDIX

APPENDIX

IN THE UNITED STATES COURT OF CLAIMS

No. 33-55

(Decided May 7, 1958)

ATLANTIC CITY ELECTRIC COMPANY v. THE UNITED STATES

Mr. N. Barr Miller for the plaintiff. *Messrs. J. Marvin Haynes, Haynes & Miller, F. Eberhart Haynes, Oscar L. Tyree* and *Joseph H. Sheppard* were on the briefs.

Mr. George Willi, with whom was *Mr. Assistant Attorney General Charles K. Rice*, for the defendant. *Messrs. Lyle M. Turner* and *James P. Garland* were on the briefs.

Opinion

MADDEN, *Judge*, delivered the opinion of the court:

The plaintiff sues for $84,105.60 of income tax paid by it for the year 1944. It claims that it should not have had to pay this tax because it was entitled to a credit which would have reduced its taxable income.

Section 26 (h) of the Internal Revenue Code of 1939 provided that a public utility corporation, in computing its surtax net income, was entitled to a credit for, i.e., a deduction of, "the amount of dividends paid during the taxable year on its preferred stock." The plaintiff was a public utility, and the stock in question qualified in all respects for the benefits of section 26 (h). The question is whether the payments made by the plaintiff during 1944 were "dividends" within the meaning of section 26 (h).

In *Public Service Electric and Gas Co.* v. *United States*, No. 318-56, — C. Cls. —, decided January 15, 1958, this court discussed the reason for the enactment by Congress of section 26 (h). It there appears that Congress desired to give to public utility companies which had financed themselves by issuing preferred stock a status, for tax purposes, similar to that of such corporations which had financed themselves by issuing bonds. Since the interest on the bonds was deductible, dividends on preferred stock were made deductible.

The payments which the plaintiff made to its stockholders, and sought to deduct from its taxable income, were not the payments of $6 per share which accrued annually on its preferred stock and which, under the terms of that stock, had to be paid before the common stockholders could be paid any dividnds. The payments here in question were payments of $20 per share, in addition to the $100 par value of the preferred shares, for the redemption of the stock. The preferred stock as issued provided that the plaintiff corporation could, at its option, redeem the shares for $120 plus accrued dividends, and the plaintiff did so redeem them. The accrued dividends so paid were clearly deductible under the provisions of section 26 (h), and they are not involved in this case. The redemption payments of $20 per share are the payments in question. As we have said, the question is whether they were "dividends" within the meaning of section 26 (h).

To the layman, a payment to a shareholder of a sum in addition to the regular dividends provided for in his stock certificate, a sum which would never be paid again because it was paid for the redemption and cancellation of the stock, would not be regarded as a dividend. But the meaning of a word in the tax statutes is not a question for a layman, unless the by no means impossible situation occurs when, as a last resort, refuge is taken in the lay meaning.

Since section 26 (h) merely uses the word "dividend" without definition, one must look elsewhere in the statutes to learn whether it applies to the instant situation in which the payment was not obviously a dividend. The plaintiff points to section 115 (a) of the Internal Revenue Code of 1939 for the definition of "dividend" for the instant purpose. That section says:

> The term "dividend" * * * means any distribution made by a corporation to its shareholders * * * out of its earnings or profits * * *.

The $20 per share payment in question was made out of accumulated earnings of the plaintiff. Therefore, the plaintiff says, it was by definition a dividend and was covered by the language of section 26 (h).

The Government says that before one reaches a conclusion as to the effect of the broad definition of dividend in section 115 (a), one must look at section 115 (c), which provides for "Distributions in liquidation" and says:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation * * * as in part or full payment in exchange for the stock.

The payments of the $120 per share for the redemption of the $100 par value stock liquidated the stock. According to section 115 (c), the entire $120 was taxable to the stockholder who received it, if it was taxable at all, only to the extent that the $120 represented a capital gain to the distributee-shareholder, and was taxable only at capital gains rates. It might well have involved no capital gain to him at all, as, for example, if he had paid $120 per share for the stock.

The Government says that section 115 (c), in saying that amounts distributed in liquidation shall be treated as "pay-

ment in exchange for the stock," not only means that they shall be so treated in the hands of the distributee-shareholder, but that they shall be so treated as regards the distributor-corporation. If they are so treated, the corporation has, for tax law purposes, not distributed a dividend, but bought a share of stock. That would not entitle it to any deduction under section 26 (h).

The Government urges that it would be an illogical and asymmetrical reading of section 115 (c) to regard it as applying only to the distributee-shareholder side of the redemption transaction, and not to the distributor-corporation side. There would, however, have been a valid reason for the distinction, if Congress chose to make the distinction. From the corporation's side, the money distributed was earnings which had accumulated in its treasury. As we have suggested above, to the distributee-shareholder it may not have represented any profit at all. He may well have, in the money market of those times, regarded a 6 percent preferred stock redeemable at $120 as worth $120, or $110, and have paid that much for it, so that the $20 was not, or was not all, profit or other income. A similar situation might occur with regard to unpaid cumulative preferred stock dividends which were finally paid, as dividends, but for most of which the shareholder had already paid when he purchased the stock in the market. Section 115 (c) would not take care of such a taxpayer. Whether any other provision of law would help him we do not know.

We are not persuaded, then, by the Government's argument for symmetry in the interpretation of section 115 (c). We think it is fair for the plaintiff to urge that the definition in section 115 (a) covers its case, and is not negatived by section 115 (c).

The plaintiff points to another provision which is in the third sentence of section 115 (c) and which says:

> In the case of amounts distributed * * * in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.

The plaintiff says that this sentence contains a negative inference that the part of a distribution in partial liquidation which *is* properly chargeable to earnings, and hence not "properly chargeable to capital account" is a distribution of earnings and is therefore a dividend, within the definition of section 115 (a). The statement in the sentence quoted above is a statement of the obvious. The Government says it was inserted to clarify the question whether, when a corporation had earnings accumulated prior to 1913, and redeemed a part of its stock at prices which took into account the value created by the pre-1913 earnings, and later distributed a dividend, the distributee could claim that the earlier distribution exhausted the post-1913 earnings and hence the later distribution was from the pre-1913 earnings and was tax free. In fact, in an earlier version of this sentence of section 115 (c), *viz.*, section 201 (c) of the Revenue Act of 1924, 43 Stat. 253, it expressly said that distributions properly chargeable to capital account should not be considered as distributions of earnings or profits "for the purpose of determining the taxability of subsequent distributions by the corporation." The Revenue Act of 1936, 49 Stat. 1648, dropped the limiting language just quoted, but Congress gave no reason for dropping it.

Our consideration up to this point shows a definition in section 115 (a) which would make the plaintiff's distribution a "dividend" for all purposes, including the purpose of the section 26 (h) deduction, and a miscellany of provisions in section 115 (c) which qualify the definition given in 115 (a). The first sentence in 115 (c) says that distributions in liquidation, though they would be dividends within the definition of 115 (a), shall not be treated,

for tax purposes, as dividends, but shall be treated as payments of purchase price of the liquidated stock. This sentence does not tell us whether these payments should be so treated as regards both the distributee-shareholder and the distributor-corporation or only as regards one of them. The second sentence of section 115 (c) which provides for determination and recognition of gain or loss is expressly applicable only to the distributee-shareholder. The third sentence could be applicable to both parties to the transaction, but the negative inference which it contains cannot have the effect of making the distributions of earnings taxable to the distributee as dividends, without contradicting the first and second sentences of the same section. The foregoing summary shows that the statutory situation is confused.

There have been other situations in which it has been advantageous to taxpayers to show that distributions made, or received, were dividends. We consider those situations for possible enlightenment on our problem.

Section 216 (a) of the Revenue Act of 1918, 40 Stat. 1057, 1069, allowed taxpayers a tax credit for the "amount received as dividends from a corporation." In *Hellmich v. Hellman*, 276 U.S. 233, the taxpayer had received, in a distribution in liquidation of a corporation, money which had been accumulated as earnings of the corporation. He claimed the credit, pointing to the definition of dividends in section 115 (a), which was section 201 (a) of the Revenue Act of 1918. The Court held that he was not entitled to the credit, in spite of the 115 (a) definition of dividends because 115 (c), then 201 (c), expressly provided that the payments in liquidation should be treated as the purchase price of the liquidated stock. The Court said, at pages 236-237:

> It is true that if § 201 (a) stood alone its broad definition of the term "dividend" would apparently include distributions made to stockholders in the

liquidation of a corporation—although this term, as generally understood and used, refers to the recurrent return upon stock paid to stockholders by a going corporation in the ordinary course of business, which does not reduce their stock holdings and leaves them in a position to enjoy future returns upon the same stock. See *Lynch* v. *Hornby*, 247 U.S. 339, 344-346; and *Langstaff* v. *Lucas* (D. C.) 9 F. (2d) 691, 694.

However, when § 201 (a) and § 201 (c) are read together, under the long-established rule that the intention of the lawmaker is to be deduced from a view of every material part of the statute, *Kohlsaat* v. *Murphy*, 96 U.S. 453, 159, we think it clear that the general definition of a dividend in § 201 (a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by § 201 (c), which, dealing specifically with such liquidation, provided that the amounts distributed should "be treated as payments in exchange for stock" and that any gain realized thereby should be taxed to the stockholders "as other gains or profits." This brings the two sections into entire harmony, and gives to each its natural meaning and due effect. The Treasury Regulations correctly interpreted the Act as making § 201 (a) applicable to a distribution made by a going corporation to its stockholders in the ordinary course of business, and § 201 (c) applicable to a distribution made to stockholders in liquidation of the corporation. And this is in accord with the rulings of the Board of Tax Appeals: *Appeal of Greenwood*, 1 B. T. A. 291, 295; *Appeal of Chandler*, 3 B. T. A. 146, 149.

The *Hellmich* case was, of course, concerned with the status of the distributed money in the hands of the distributee, as a dividend *vel non*. The Court's language, like

the language of the statute, does not tell us whether the payment would have the nondividend status as regards the distributor-corporation, which is our problem in the instant case. The Treasury Regulation approved by the Court, Treasury Regulations 45 (1919 ed.) Art. 1548, is as broad as the statute and the Court's opinion. *Foster* v. *United States*, 303 U.S. 118, affirming 84 C. Cls. 193, was another case in which the status of the payment in the hands of the distributee-shareholder was involved, and the decision was that the broad definition of dividends in 115 (a) was overridden by the specific provisions of 115 (c).

The plaintiff says that the language of section 115 (c) and of the judicial opinions and of the executive regulations should be limited to the situation which, the plaintiff says, all of the users of the language had in mind, *viz*, the status of the money in the hands of the distributee.

We now consider a comparable statutory situation in which the important question is the one involved in the instant case, *viz*, the status of the distribution from the standpoint of the distributing corporation. For the purpose of compelling the distribution of corporate profits so that they could be taxed in the hands of the shareholders, Congress in section 14 of the Revenue Act of 1936, *supra*, imposed a surtax on undistributed corporate profits. See *Reed Drug Co.* v. *Commissioner*, 130 F. 2d 288 (C. A. 6). In the section which became section 27 (g) of the Internal Revenue Code of 1939, Congress provided a credit against the undistributed profits taxes for that part of a distribution in liquidation which was properly chargeable to earnings and profits. The section provided that such a payment should be "treated as a taxable dividend paid."

The Government says that if the plaintiff is right in its claims as to the universality of the definition of dividend in section 115 (a) and the one-sidedness of the provision in the first sentence of section 115 (c), limiting its capital gains

treatment to the funds in the hands of the distributee, there would have been no reason for the insertion of section 27 (g). It says that, under the plaintiff's assumptions, the payments described in section 27 (g) would of course have been dividends and would have been covered by the general language giving credit for dividends paid, without any need for being specially "treated as a taxable dividend paid." We think there is force in the Government's argument. We wish Congress had been equally specific and clear in its writing of section 26 (h), with which we are here concerned.

In *Helvering* v. *Credit Alliance Corp.*, 316 U.S. 107, the corporation had distributed accumulated earnings in a liquidation transaction and claimed the statutory credit for dividends paid. The Court said, at page 110:

> Although a distribution in liquidation of earnings * * * does not constitute a dividend in the proper sense of the term,[1] subsection (f)[2] categorically declares that a liquidating distribution, to the extent it is composed of such earnings, shall, for the purposes of computing the dividends-paid credit "*be treated as a taxable dividend paid.*"

In *St. Louis Co.* v. *United States*, 237 F. 2d 151 (C. A. 3), *cert.* den. 352 U.S. 1001, the corporation taxpayer claimed a dividends-paid credit for payments made in a distribution in liquidation. It had a deficit balance of accumulated earnings, but if had current earnings in the year of distribution. Under the definition of dividends in section 115 (a) and the provisions of section 115 (b), applied without consideration of section 115 (c), its contention would have been right. But the Court held that the statutes made a distinction between distributions made by a going corporation and those made by a corporation in liquidation; that in the latter

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[1] The Court here cited *Hellmich* v. *Hellman*, *supra*.

[2] Section 27 (g) of the Internal Revenue Code of 1939.

case the distributions in liquidation would be treated as dividends only if a statute such as section 27 (g) specifically so provided, and that the taxpayer's situation did not comply with section 27 (g) because it did not have accumulated earnings, but a deficit. In *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177 (C. A. 7), the court gave similar treatment to a comparable situation.

Another instance of a "dividends paid" credit in the statutes is a section of a 1935 Act, 49 Stat. 908, which became section 121 of the Internal Revenue Code of 1939, which gave to banks and domestic insurance companies a tax deduction for dividends paid on their preferred stock. The Secretary of the Treasury suggested that the bare language in the draft of the bill "any dividend paid" should be qualified by the parenthetical expression "(not including any distribution in liquidation)" and that change was made. It is fair to urge that the change was made because the general language "any dividend paid" would have, without the qualification, included distributions made in liquidation, according to the definition of dividends in section 115 (a).

The plaintiff urges that the purpose of Congress in providing the tax credit to public utility corporations for dividends paid on preferred stock will be, in part, frustrated if they are not allowed such credit for distributions in liquidation. It should be said that there is no evidence whatever that Congress put its mind on the particular question here involved. The plaintiff's argument is that the purpose of Congress was to give to public utility corporations which had financed themselves by issuing preferred stock the same tax status as those which had financed themselves by issuing bonds. The only payments discussed by the witnesses who spoke for 26 (h) were the regularly recurring, cumulative, charges in the form of dividends on preferred stock which corporations which so financed themselves had to pay. The more esoteric questions of tax treatment of the issuance of bonds at a premium or at

a discount, or their redemption at a premium or at a discount, and how similar tax treatment of preferred stock so issued or so redeemed could be provided for, were not raised. If they had been, they might well have confused the principal objective of the legislation, which was to get the tax credit for the normal recurring payments which all persons would recognize as dividends.

We get no real help from a consideration of the purpose of the legislation. We are obliged to conclude that Congress meant by the word dividends in section 26 (h) whatever meaning the applicable statutes gave to the word in its proper context. We are, therefore, thrown back upon section 115 and its several subsections. As our discussion has indicated, section 115, and other legislation relating to analogous situations, give rise to conflicting inferences.

Our instant problem has not been decided by any court. The Supreme Court of the United States, and other courts which have adjudicated related problems, have said in effect that the general definition of dividends in section 115 (a) is not applicable to distributions in liquidation; that to whatever extent they are to be treated as dividends, the justification must be found in section 115 (c) or elsewhere. We recognize that most, perhaps all, of such decisions could have been reached without the use of language as inclusive as that used by the courts. We cannot, however, ignore these expressions of opinion.

The question being so evenly balanced, on the basis of the text of the statutes and the logical inferences to be drawn from them, we are persuaded by the expressions of the other courts to the conclusion that the distribution here in question was not a dividend within the meaning of section 26 (h).

The plaintiff's petition will be dismissed.

It is so ordered.

LARAMORE, *Judge*; WHITAKER, *Judge*; LITTLETON, *Judge*; and JONES, *Chief Judge*, concur.

Findings of Fact

The court, having considered the evidence, the report of Trial Commissioner George H. Foster, the briefs and arguments of counsel, makes findings of fact as follows:

1. Plaintiff is, and during 1944 was, a public utility engaged in the sale of electric energy, and the rates for such sale have been established and approved by the Board of Public Utility Commissioners of the State of New Jersey.

2. Within the time prescribed by law the plaintiff filed with the collector of internal revenue for the Second New York District its Federal income tax return for the taxable year 1944 and paid to the said collector, on or before the statutory due dates, the normal tax and surtax shown on said return.

3. Plaintiff corporation was formed in 1924 by an agreement of merger between five utility companies. Paragraph third of the agreement of merger provided in part that upon the vote of not less than a majority of the then outstanding common stock, the preferred stock could be redeemed, in whole or in part, at any time after three years from the issue thereof at the price of $120 per share, plus accumulated dividends. The agreement of merger required that notice of intention to redeem the shares be mailed to holders of record thirty days before the date of redemption.

On March 27, 1944, at a meeting of its board of directors, plaintiff resolved to call for redemption all of its then outstanding shares of 6 percent preferred stock owned by the general public at a redemption price of $120 per share and to purchase for cancellation the shares of such stock owned by its parent corporation, the American Gas and Electric Company.

On April 15, 1944, the company, having complied with the requirements of the third paragraph of the agreement of merger, issued notice of redemption to all of its public stockholders.

4. On May 15, 1944, plaintiff, through its redemption agent, the Chemical Bank and Trust Company, New York City, redeemed from its general public stockholders, at a premium of $20 per share, 26,283 shares of its 6 percent preferred stock. The redemption agent paid said stockholders $3,199,692.42. This amount was composed of the following items:

Repayment of stockholders' investment in the 6 percent preferred stock	$2,628,300.00
Accrued dividends on the 6 percent preferred stock computed at the rate of $6 per annum from Feb. 1, 1944, to May 15, 1944	45,732.42
Premium on 26,283 shares, computed at $20 per share	525,660.00
Total	3,199,692.42

Plaintiff recorded on its books of account the above payments in the following manner:

Its capital stock account was reduced in the amount of $2,628,300 by a charge to that account, and the cash account was reduced by the same amount by crediting that account.

The preferred dividend account was charged with $45,732.42, and the cash account was reduced in the same amount by a credit.

Plaintiff's earned surplus was reduced by the premium of $525,660 by a charge to that account, and the cash account was reduced by a credit of the same amount.

5. At the same time as the redemption of the publicly held preferred stock, the plaintiff purchased for cancellation 30,592 shares of its 6 percent preferred stock held by its parent, the American Gas & Electric Company. The funds for these redemptions and purchase (except for about $94,000) were obtained by the plaintiff by a new issue of 55,000 shares of 4 percent preferred stock.

6. The 6 percent preferred stock referred to in finding 4 above had been issued prior to October 1, 1942, and the dividends thereon were cumulative, limited to the same amount, and payable in preference to the payment of dividends on other stock. The par value of such stock was $100 and it was redeemable at any time at 120 percent of par plus accrued dividends. The stock had no voting power and in the distribution of assets, other than profits, the holders thereof were entitled only to payment of the par value of the stock plus cumulative dividends then unpaid. The rate of return on the stock could not be changed by action of plaintiff's board of directors or otherwise.

7. In filing its 1944 return, the plaintiff did not include as a part of its dividend-paid credit under Section 26(h) of the Internal Revenue Code of 1939 the premium of $525,660 paid as part of the redemption price of the 26,283 shares of 6 percent preferred stock. The return, insofar as the dividend-paid credit under Section 26(h) was concerned was accepted by the Commissioner as filed. The dividend-paid credit claimed in the 1944 return, amounted to $288,675.05, and was composed of the following items:

Dividend payments made on Feb. 1, 1944, on $6 cumulative preferred stock	$85,312.50
Accrued dividends on the $6 cumulative preferred stock computed at the rate of $6 per annum from Feb. 1, 1944, to May 15, 1944	45,732.42
Accrued dividends paid on Apr. 15, 1944, on $6 cumulative preferred stock	37,730.13
Dividends paid on May 1, 1944, on $4 cumulative preferred stock	9,900.00
Dividends paid on Aug. 1, 1944, on $4 cumulative preferred stock	55,000.00
Dividends paid on Nov. 1, 1944, on $4 cumulative preferred stock	55,000.00
Total	288,675.05

8. The aforesaid redemption premium of $525,660 was paid out of earned surplus and no portion thereof represented cumulative and unpaid dividends for any prior year.

9. On or about July 29, 1946, plaintiff duly filed with the Commissioner of Internal Revenue, through the appropriate collector, a claim for refund of income taxes for the year 1944 in the amount of $84,105.60. In this claim for refund plaintiff claimed that in addition to the dividend-paid credit of $288,675.05, which was allowed by the Commissioner of Internal Revenue, he should have allowed, under Section 26(h) of the Internal Revenue Code of 1939, as a part of the dividend-paid credit the redemption premium of $525,660 on the 6 percent preferred stock as said payment had been made out of earned surplus. The plaintiff has not been notified of any action on the claim by the Commissioner of Internal Revenue.

10. The redemption by the plaintiff on May 15, 1944, of 26,283 shares of $6 preferred stock held by the general public and the purchase for cancellation by the plaintiff on the same date of 30,592 shares of such stock held by its parent, the American Gas & Electric Company, constituted the retirement of the entire issue of that stock.

11. On the dates shown below the American Gas & Electric Company made the following advances to the Atlantic City Electric Company, plaintiff herein:

June 1941	$ 500,000
July 1941	500,000
August 1941	500,000
November 1941	500,000
January 1942	500,000
	2,500,000

At the time the above advances were made to the plaintiff, they were recorded in an account styled "Advances on Open Account—Loan." Subsequently, in August 1942, pursuant to an order of the Securities and Exchange Commission the aforesaid advances were transferred to Capital Surplus and during the same month such advances were transferred to an account styled "Other Reserves—Reserve for Possible

Adjustments for Utility Plant." Sometime prior to the aforesaid entries, the plaintiff was required to reclassify its electric plant to original cost for the purpose of writing off amounts paid in excess of original cost for the purchase of operating properties and in December 1943, plaintiff was ordered by the Federal Power Commission to write off the aforesaid adjustments as follows:

Retirement Work in Progress	$ 193,786.92
Reserve for Depreciation	3,245.37
Reserve for Possible Plant Adjustments .	2,500,000.00
Earned Surplus	931,027.96
	3,628,060.25

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is therefore dismissed.